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STATE FOR EB/IFD/OIA AND EUR/NB
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COMMERCE FOR ITA/MAC/DAS/EUR (JBURGESS)

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TAGS: EINV KIDE ECON KTDB LH
SUBJECT: LITHUANIA 2005 INVESTMENT CLIMATE STATEMENT

SUMMARY

¶1. To maintain its high rate of growth, Lithuania needs more foreign investment. The government affords foreign investors equal protection to domestic investors, and sets few limitations on their activities. Foreign investors have the right to repatriate or reinvest profits without restriction, and can bring disputes to the International Center for the Settlement of Investment Disputes. Lithuania automatically extended protections to European Community trademarks and designs when it acceded to the EU on May 1, and has stepped up seizures of pirated goods. However, it remains on the Special 301 Watch List, because piracy rates remain high. The government harmonized national company law with EU requirements, offers special incentives, such as tax concessions, to strategic investors, and has nearly completed major privatizations. U.S. executives report burdensome procedures to obtain licenses and residence permits as well as corruption in the lower and middle ranks of government. Labor shortages, the result of increased emigration to the EU, affect a few sectors. The United States is the sixth largest investor in Lithuania, with investments totaling USD 481 million (8.5 percent of total FDI). End Summary.

OPENNESS TO FOREIGN INVESTMENT

¶2. Lithuania has one of the fastest growing economies in Europe, with GDP growth of nine percent in 2003, and 6.7 percent during the first three quarters of 2004. Domestic consumption and investment drove Lithuania's rapid growth in 2003. External factors, such as rising fuel costs, coupled with a shortage of qualified labor, slowed growth in 2004. The private sector now produces more than 80 percent of the country's GDP. The Lithuanian Development Agency's annual survey of foreign investors reports that 94 percent of investors are satisfied with their investment, up from 80 percent in 1997. Among the attractions of Lithuania's investment climate are a large and diversified economy, investment laws that conform to EU standards, a low corporate tax, a very well educated workforce, the region's best developed infrastructure, a stable democratic government and banking system, leading specialists in biotechnology, lasers, telecommunications and information technologies, and a strategic location between the EU and Russia.

¶3. Lithuanian income levels still lag well behind the rest of the EU, with per capita GDP in 2004 at 46 percent of the EU average. The government needs to attract more greenfield investments, because Lithuania will likely lose its current competitive advantages of low interest rates and an inexpensive labor force in the future. Though there have been recent investments from Thailand, Austria and France, the overall investment flow is not impressive. Substantial inflows of capital from EU structural funds (over USD one billion over the next three years) should provide a boost to the economy.

A level playing field for all investors

¶4. The government welcomes foreign investors and requires no special permit to invest in Lithuania. The law grants equal protection to foreign and domestic investors. Foreign investors have free access to all sectors of the economy, with some limited exceptions:

-- Article 8 of The Law on Investment prohibits the investment of foreign capital in sectors related to the security and defense of the State; and

-- The law requires governmental permission and licensing for commercial activities that may pose a risk to human life, health, or the environment, including the manufacture of, or trade in, weapons.

The government has recently expanded the number of areas in which investment is permissible:

-- Legal amendments in 2000 eliminated the provisions of Article 13 that established a list of commercial activities exclusively permitted to either State or municipal enterprises;

-- The same amendments opened mass media enterprises to foreign investment; and

-- The parliament passed amendments to Article 47 of the Constitution in 2001 permitting the sale of agricultural land to foreigners. Previously, the Constitution had permitted foreigners to buy agricultural land only when they owned buildings on agricultural land. As part of its EU accession agreement, however, Lithuania established a seven-year transitional period wherein EU citizens and companies are restricted from purchasing agricultural and forestry land. This agreement, however, granted exceptions to foreign nationals who are permanent residents of Lithuania and who have been engaged in the agricultural business for at least three years and to foreign organizations that have established representative or branch offices in Lithuania. These entities may acquire agricultural and forestry land on equal footing with Lithuanian citizens.

Investments

¶5. The law defines investments as funds or other financial assets used to generate profit or achieve charitable or public (governmental) goals. It permits several forms of investment:

-- Establishment of an enterprise, or acquisition of a part or whole of the authorized capital of an operating enterprise registered in Lithuania;

-- Acquisition of securities of any type;

-- Creation, acquisition, and increase in the value of long-term assets;

-- Lending of funds or other assets to business entities in which the investor owns a stake, which in turn makes control or considerable influence over the company possible; and

-- Concession or leasing agreements.

¶6. Foreign investors can contribute capital in the form of money, movable or immovable assets, intellectual or industrial property. Foreign entities may also establish branches or representative offices, neither of which, however, have the same rights as a legal person. (Branches may engage in commercial activities; representative offices may not.)

Privatization nearly complete

¶7. The law treats foreign investors equitably in privatization programs. The government has successfully privatized most state enterprises and property included in the initial privatization program. Major assets still in government control include the Lithuanian electric power company Lietuvos Energija, the national airline Lietuvos Avialinijos, and the railway company Lietuvos Gelezinkeliai.

¶8. Privatization of state and municipal companies yielded USD 330 million in 2003, 2.6 times that in 2002. VP Market's purchase of 77 percent of the Western Power Grid's stock for USD 196 million represented the largest privatization transaction. In March 2004, the government sold 34 percent of Lithuania's main natural gas distributor Lietuvos Dujos (Lithuanian Gas) to the Russian company Gazprom. In 2003, the government privatized two large state companies. Mineraliniai Vandenys purchased the alcohol company "Stumbras" for $55 million, and the Polish Company Belvedere Dystrybucja purchased the alcohol company "Vilniaus Degtine" for USD 7.6 million. In 2003, the government halted the privatization of the Eastern Power Grid, rather than sell it to the only bidder, the Estonian state-owned power company "Eesti Energia," amid concerns that the prospective buyer had excessive debt liabilities.

¶9. The government established the State Property Fund to manage and privatize state assets. It commonly screens companies according to size and performance criteria when privatizing state or municipal property and during public procurement. The privatization of state property is carried out by the following methods:

-- Public share subscription (for large and medium scale enterprises);

-- Auctions (for small enterprises or their divisions);
-- Tenders or auctions for convertible currency;

-- Direct negotiations;

-- Leases with the option to purchase; and

-- Combinations of the above methods.

CONVERSION AND TRANSFER POLICIES

¶10. Lithuanian law requires that all transactions in the country be made in the national currency, the Litas. On February 1, 2002, the government pegged the Litas to the euro at a rate of 3.45:1, under a currency board arrangement. The Bank of Lithuania ties the amount of currency in circulation to the size of reserves. There are no restrictions on the transfer or conversion of the Litas. Lithuania is interested in joining the European Monetary Union and acceded to the Exchange Rate Mechanism II in June 2004 as a step towards joining the euro. Lithuania's strong macroeconomic performance and stable monetary policy may enable it to be among the first wave of countries to join the eurozone.

EXPROPRIATIONS AND COMPENSATION

¶11. Lithuanian law permits expropriation, on the basis of public need, but with compensation at market value in convertible currency. There have been no cases of expropriation of private property by the government since
¶1990. Moreover, the government has been denationalizing and returning private property seized by Soviet authorities during the occupation.

PERFORMANCE REQUIREMENTS AND INCENTIVES

¶12. Lithuania provides special incentives to investors whom the national or municipal governments designate strategic investors, though the criteria used to determine a strategic investor varies from project to project. In general, the national government requires that a strategic investor invest USD 50 million or more. Municipalities may tie the designation to different criteria, such as the number of jobs created and the environmental benefits involved. Strategic investors may be rewarded with special business conditions, such as favorable tax incentives, for up to ten years. Significant tax incentives apply to foreign investments made before 1997. Municipalities may grant special incentives to induce investments in municipal infrastructure, manufacturing, and services.

¶13. The government applies performance requirements uniformly to domestic and foreign investors. Government Resolution No. 918 of July 15, 2003 requires offset agreements as a condition for awarding contracts to procure military equipment valued at more than LTL 5 million (USD 1.9 million). Offsets are obligations the government imposes that require companies to provide services, create jobs, or purchase local goods as a condition for the contract's award. The Embassy has not, however, processed any Letters of Request (LOR) for military equipment or services exceeding this ceiling since the resolution went into effect. Foreign investors have the same rights as local firms to participate in government-financed and -subsidized research and development (R&D) programs. There are few such opportunities, however, since most R&D financing is awarded to state-owned institutes. Lithuania's external tariffs are aligned with EU requirements. The requirements that labels must be translated into Lithuanian may pose a non-tariff barrier to trade.

¶14. There are no requirements for local content or purchasing from local sources as a condition for investment or public purchases. Municipalities have the right to ask investors to develop roadways or other infrastructure adjoining their project, though such development is subject to negotiations. Lithuania's EU membership has given foreign firms the additional right to appeal adverse governmental rulings to the European Court of Justice. Lithuania's modified "Law on Public Procurement," which came into effect on March 1, 2003, is completely harmonized with the EU Acquis Communautaire.

Difficulties with residency permits

¶15. Americans and citizens of the EU can stay in Lithuania no more than 90 days without a visa (and no more than 180 days per calendar year). Those who stay longer face criminal sanctions and deportation. The current residence permit process is not user-friendly. Though Lithuanian law mandates that permits be available through its embassies abroad, permits can in practice only be obtained in Lithuania. Decisions by the Migration Office regarding the issuance of residency permits may take up to six months. The Embassy has learned of instances where American Citizens have either been trapped in Lithuania or asked to leave solely because their application for a residency permit was not processed in a timely manner. By law, there are reports that the Migration Office imposes varying and sometimes capricious demands regarding the documentation required for a residency permit. Companies wishing to hire citizens of former Soviet republics may face even more restrictive requirements.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

¶16. The law places no limits on foreign ownership or control over investments. Foreign investors have the right to repatriate profits, income, or dividends, after payment of taxes, or to reinvest their income without any limitation. Lithuania introduced a law restricting monopolies in 1993, and a law on competition in 1999. An anti-monopoly committee oversees implementation of these laws.

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PROTECTION OF PROPERTY RIGHTS/DISPUTE SETTLEMENT
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¶17. Lithuanian law protects foreign investments and the rights of investors in several ways.

-- The Constitution and the law on Foreign Capital Investment protect all forms of private property against nationalization or requisition.

-- International agreements offer protections, such as the 1958 New York Convention on the recognition and enforcement of foreign arbitral awards.

-- Bilateral agreements with the United States and other western countries on the mutual protection and encouragement of investments reinforce these protections.

-- The law on capital investment in Lithuania and other acts regulate customs duties, taxes, and relationships with financial and inspection authorities. This law also establishes the order of dispute settlement.

-- In the event of justified expropriation, investors are entitled to compensation equivalent to the market value of the expropriated property.

-- Foreign investors may defend their rights under the Washington Convention of 1965 by applying to either Lithuanian courts or directly to the International Center for the Settlement of Investment Disputes. To date, Lithuania has not been involved in any investment disputes with American or other foreign investors.

-- State institutions and officials are obliged to keep commercial secrets confidential and must pay compensation for any loss or damage caused by illegal disclosure.
The laws did not change significantly, other than the reform of the enforcement system in 2003, which made it possible to hire private bailiffs to enforce court judgments.

Company law conforms to EU requirements

¶18. Lithuania has harmonized its company law with EU standards, including the principles of the free establishment of companies, protection of shareholders' and creditors' rights, free access to information, and registration procedures. The following Lithuanian laws address company law: the "Company Law" and "Law on Partnerships" (both modified January 1, 2004), the "Law on Personal Enterprises" of January 1, 2004, the "Law On Investments of 1999," the "Law On Bankruptcy of Enterprises of 2001," and the "Law on Restructuring of Enterprises of 2001."

¶19. The Civil Code of 2000 governs commercial guarantees and security instruments. It provides for the following types of guarantee and security instruments to secure fulfillment of contractual obligations: forfeiture, surety, guarantee, earnest money, pledge, and mortgage. Bankruptcy

procedures, which are regulated by the "Law on Bankruptcy of Enterprises," are consistently applied. The law establishes the following order of creditors' claims:

-- Claims by creditors that are secured by a mortgage/pledge of debtor;

-- Claims related to employment;

-- Tax, social insurance, and state medical insurance claims, and claims arising from loans guaranteed or issued on behalf of the Republic of Lithuania or its Government; and

-- Other claims.

Lithuania remains on the Special 301 Watch List
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¶20. Lithuania observes international standards and subscribes to international conventions on the protection of intellectual property. Lithuania is a member of the World Intellectual Property Organization (WIPO) and became a member of the World Trade Organization (WTO) on May 31,
¶2001. It is a signatory to the following IPR-related treaties and conventions:

-- The Paris Convention for the Protection of Industrial Property in 1990 (effective May 22, 1994);

-- The Berne Convention for the Protection of Literary and Artistic Works of 1886 (effective December 14, 1994);

-- The Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations of 1961 (effective July 22, 1999);

-- The Nice Agreement Concerning International Classification of Goods and Services of 1957 (effective February 22, 1997);

-- The Madrid Protocol of 1989 (effective November 15, 1997);

-- The Patent Cooperation Treaty of 1970 under the auspices of WIPO (effective July 5, 1994);

-- The WIPO Copyright Treaty of 1996 (effective March 6, 2002);

-- The WIPO Performances and Phonograms Treaty of 1996 (effective May 20, 2002); and

-- The Trademark Law Treaty of 1994 (effective April 27, 1998).

Lithuania, in 2002, enacted regulations to protect confidential test data that pharmaceutical firms submit for

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patent and trademark registration. Lithuania's parliament is expected to ratify the 1973 and 2000 Conventions on the Grant of European Patents.

¶21. Following EU accession, Lithuania extended protection to Community trademarks, designs and applications. Though the issue is under review by the Ministry of Culture, Lithuania has not yet brought its national law protecting biological inventions into compliance with EU Directive 98/44.

¶22. Lithuania remains on the 2004 Special 301 Watch List. The country remains a transshipment point for pirated optical media products from the East, particularly Russia, to Europe. Although Lithuania amended its Copyright Law in 2003 to bring it in line with the EU copyright directive, penalties for confiscated pirated software and media worth less than LTL 12,500 (USD 4,800) remain low. The rate of CD piracy in 2003, estimated at between 55-85 percent of all sales, was high. The software piracy rate in 2003 (58 percent) was also high. Law enforcement efforts against pirates improved in 2004, with the number of seized pirated CDs increasing fourfold. The Lithuanian Music Industry Association reported that the Criminal Police closed six Internet sites in 2004 for illegally distributing films, computer games, music and software that had not yet reached retail outlets.

TRANSPARENCY OF THE REGULATORY SYSTEM

¶23. Business in Lithuania is still fairly heavily regulated. More than 50 agencies regulate the business environment and possess the legal standing to close a business. Investors and lawyers complain that many laws

and regulations are vague, confusing, and often contradictory. A U.S. executive noted that government officials are not held accountable for the untimely or incorrect implementation of regulations or ministerial decrees, and that there is no mechanism within ministries to appeal these decisions. U.S. executives have complained about a lack of clarity in the government's procurement rules, bureaucratic incompetence, and a lack of transparency in licensing rules.

¶24. U.S. corporate representatives have noted lengthy bureaucratic procedures to obtain customs clearances and other certifications. The Executive Director of the local Investors' Forum noted that it takes approximately 20 days to start a business in Lithuania.

¶25. The government gives the business community little advance notice of new legislation, and still less opportunity for comment. It usually does not publish new laws in draft form, nor does it publish an analysis of its responses to public commentary. A U.S. company executive noted that the government does not engage in active or constructive dialogue with industrial and trade associations to solicit their views before enacting legislation.

¶26. Labor, health, and safety laws may distort investment because strict labor laws governing working hours do not afford companies needed flexibility. Companies have also complained about burdensome health and lighting requirements.

Tax Burden

¶27. The government reduced the corporate profit tax on January 1, 2004 to 15 percent, and plans to eliminate the turnover tax, currently at 1 percent, in mid-2005. It is also considering reducing the personal income tax from the current 33 percent to 30 percent. Local analysts have drawn our attention to the fact that while the corporate tax is low, the total tax burden remains high, since companies must pay a 31 percent social security tax on wages. The government is considering a proposal from the Investors' Forum to limit payment of social security tax to the first LTL 5,000 (USD 1900) of an employee's salary. Analysts have noted that a foreign bank extending a loan to finance a company would need to pay a ten percent withholding tax, twice the rate a Lithuanian bank would have to pay.

EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

¶28. Government policies do not interfere with the free flow of financial resources or the allocation of credit. Commercial credit and short-term, trade-related loans are readily available. Demand for credit is high due to low interest rates, and the loan market expanded by 52 percent in 2003. Interest rates will likely rise in 2005-2006 after Lithuania adopts EU requirements that tax interest from deposits. A recent IMF delegation on an annual Article IV consultation mission to Lithuania noted that inflation, expected to be just under 1.5 percent in 2004, will likely exceed 2.5 percent in 2005. The mission noted several signs that point to an increased risk that the economy will overheat in 2005 including:

-- High capacity utilization;
-- Continued robust growth of credit, driven by low interest rates;
-- Declining unemployment;
-- Acceleration in wage growth;
-- Increases in property prices;
-- Rapid growth in the current account deficit; and
-- Output exceeding potential.

¶29. The banking system is stable, well-regulated, and conforms to EU standards. The privatization of all state-owned banks was completed in 2002. Foreign banks may operate in Lithuania through branches, representative offices, and subsidiaries or through the acquisition of shares in local banks. Any acquisition involving ten percent or more of a local bank's share capital requires approval by the Bank of Lithuania. The total assets of the country's largest banks on October 31, 2004 amounted to LTL 3.19 billion (USD 1.24 billion). Commercial banks have dramatically expanded their range of services, including leasing, insurance, asset management and investment banking. Credit cards have become increasingly popular in Lithuania. Lithuania's response to the 1998 Russian financial crisis included the restructuring of the banking sector and increased governmental oversight.

¶30. There are no restrictions on portfolio investment.

Portfolio investment, however, has not attracted many foreign investors due to the small number of companies listed on the National Stock Exchange, whose market capitalization, as of May 2004, amounted to approximately LTL 20.221 billion (USD 7.84 billion). In May 2004, the government privatized 44.3 percent of the National Stock Exchange's shares and 32 percent of the Lithuanian Central Depository's shares to OMHEX, Northern Europe's largest stock exchange operator. Three different authorities supervise the financial market -- the Bank of Lithuania supervises commercial banks and credit unions, the Securities Commission supervises the securities market, and the Insurance Supervisory Commission supervises insurance companies. The law requires these institutions to cooperate with the respective EU authorities. The Embassy is not aware of any cases of local "stable Shareholder" arrangements that would restrict foreign investment.

POLITICAL VIOLENCE

¶31. Lithuania has not witnessed any recent incidents involving politically motivated damage to projects and/or installations. There have been no nascent insurrections, belligerent neighbors, or other politically motivated activities.

CORRUPTION

¶32. Most large foreign investors report that senior officials are often very helpful in solving problems. The Investors' Forum, which counts large corporations among its members, reports no outstanding issues with corruption. The small and medium enterprise (SME) sector holds a different perspective on the Lithuanian bureaucracy, however. These businessmen describe lower level bureaucrats as rigid, unhelpful, corrupt, often abusive, and sometimes displaying an anti-business attitude. The Lithuanian press is replete with stories of tax inspectors, economic police, and customs officials who make unreasonable demands on small businesses. Many companies agree that the government appears to be biased in favor of big business, which are seen as a ready source of capital and employment, in spite of the existence of several official programs to promote SMEs.

¶33. The Special Investigation Service (Specialiuju Tyrimu Tarnyba or STT) was established in 1997, under the auspices of the President of the Republic, to fight corruption. The law treats bribery in any form (giving or receiving) as a criminal act. Lithuania is a signatory to the OECD convention on combating bribery and hosts a representative office of Transparency International. The government stepped up oversight of the administration of EU transfers and fought corruption in the State Border Protection Service and Customs. Efforts to combat corruption, however, stalled in the second half of 2004 because of protracted disputes among politicians, prosecutors, and the STT about how to proceed. In September, the STT Chief resigned as a result. Parliament also failed to pass a Code of Ethics for either Civil Servants or Politicians.

¶34. Transparency International's Global Corruption Barometer survey, released in December 2004, noted that one in three Lithuanians admitted paying a bribe during the past twelve months. Those polled indicated that the customs service is the most corrupt element of society, followed by political parties and the parliament, the courts, the police, and the health care system. The Embassy has funded ethics training for government officials in procurement and other areas.

BILATERAL INVESTMENT AGREEMENTS

¶35. Lithuania has commercial relations with more than 160 countries, including free trade agreements with 20 trading partners. It has concluded "Agreements Concerning the Promotion of Mutual Investment" with all EU member states (except Ireland), the United States, Australia, China, Iceland, Israel, Korea, Russia, Venezuela, Argentina, Kazakhstan, Turkey, and a number of Central and Eastern European countries. It has signed Most Favored Nation agreements with 22 countries, including the United States. The United States and Lithuania have signed and ratified the following agreements:

-- Charter of partnership between the USG, Estonia, Latvia and Lithuania;

-- Agreement on reciprocal investment protection and encouragement (recently amended to avoid incompatibilities

with obligations arising out of EU membership);

-- Treaty on avoidance of double taxation;

-- Treaty on legal assistance in criminal matters;

-- Treaty on extradition; and

-- Treaty on mutual assistance in Customs matters.

OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

¶36. Coverage from the Overseas Private Investment Corporation (OPIC) is available for U.S. investments in Lithuania. Lithuania is a member of MIGA (the Multilateral Investment Guarantee Agency). The embassy purchases local currency at an exchange rate that varies on a daily basis. On December 28, 2004, it was LTL 2.53 to the dollar.

¶37. Lithuania has concluded "Agreements on the Avoidance of Double Taxation of Income and Capital and the Prevention of Fiscal Evasion" with Armenia, Azerbaijan, Belarus, Belgium, Canada, China, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Iceland, Ireland, Italy, Kazakhstan, Latvia, Malta, Moldova, the Netherlands, Norway, Poland, Portugal, Romania, Russia, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, the United States, and Uzbekistan.

LABOR

¶38. Lithuania is a member of the International Labor Organization (ILO) and adheres to its conventions. Lithuanian work requirements are stricter than in other EU countries. By law, white-collar workers have a 40-hour workweek and blue-collar workers a 48-hour workweek, with premium pay for overtime. Minimum workplace health and safety standards are in place, but they are sometimes ignored. A U.S. company executive told us that the labor regulations lack flexibility and preclude him from hiring seasonal labor. The average monthly wage is USD 470. The unemployment rate, at 11.3 percent in the second quarter of 2004, is decreasing. Despite a planned increase in the minimum wage, analysts do not expect unemployment to rise, since many workers migrate abroad seeking better wages. Structural unemployment in the health care system, one of Lithuania's least reformed sectors, may rise if the government decides to close one or more hospitals.

¶39. Lithuania's EU accession has led to a migration of its labor to other EU countries. The Ministry of Labor expects that as many as 360,000 workers, about one-quarter of the country's working-age population, will have left Lithuania by the end of 2004. According to government data, emigration increased by 64 percent in the first half of 2004 as compared to the same period in 2003. The impact of emigration varies by sector. In September 2004, the Lithuanian Trucking Association, for example, reported a shortage of 3,000-4,000 truck drivers. Large retail stores have also reported some difficulty in filling positions. The construction sector anticipates shortages in the future. Industry analysts expect that foreign workers that speak Russian (and can therefore operate in the Lithuanian labor market) will increasingly fill the shortages in sectors as diverse as textiles and medical services. The government will likely begin increasing foreign worker quotas to enable individuals from Belarus and Ukraine to fill areas of labor shortage.

¶40. Emigration has led to salary increases in certain sectors, such as construction and transportation. It is anticipated that salaries in these two sectors will increase by 25 percent in 2005. A recent study projected that Lithuania's salary growth in 2005, projected to be a 9.9 percent nominal increase and 7.7 percent real increase, will likely be the highest in the world. Government plans to raise the minimum wage to LTL 600 (USD 230) from the current 500 (USD 190) are likely to negatively affect the textile industry and other sectors that rely upon inexpensive labor.

¶41. Since unions do not have a very large membership base, the labor movement is weak. The unpopularity of unions is a legacy from Soviet times, when they were co-opted by the Soviet regime. Unions are often reluctant to exert pressure on management for fear of jeopardizing jobs in a job market characterized by high unemployment. There have been no major industrial strikes since independence. There were no reports of political violence or politically motivated damage to property from 1991 through 2003. Civil disturbances are unlikely.

FREE TRADE ZONES

¶42. Lithuania has Free Economic Zones (FEZ) in the cities of Klaipeda, Kaunas and Siauliai. Klaipeda is the country's largest seaport, Kaunas is an air, road, and rail hub, and Siauliai hosts the largest airport in the Baltics. Business conditions in the zones favor investment in manufacturing and exports. Companies operating within the zones enjoy:

-- 80% corporate tax reduction for the first five years of operation, and 50% for the next five years;

-- Exemption from customs taxes;

-- Exemption from Value Added Tax; and

-- A 50% discount on land leases.

There are currently four businesses operating in the Klaipeda FEZ. This largest of Lithuania's zones, with 130 million euros (USD 174 million) in total foreign investment, has signed contracts with four more enterprises to begin operations in 2005.

¶43. Companies operating in the FEZ receive the same legal guarantees as those operating elsewhere. Parliament approved a law on the fundamentals of free economic zones on June 28, 1995 that regulates conditions for the establishment of free trade zones and the legal status of firms operating in such zones. Lithuania's EU Accession agreement permits the indefinite operation of existing FEZs, but precludes the establishment of new ones.

FOREIGN DIRECT INVESTMENT STATISTICS

¶44. Lithuania is an attractive location for foreign investors, and a competitive center for product sourcing in the region. The country has:

-- A highly skilled, low-cost labor force, making it an attractive production alternative to the West;

-- Strong production potential to serve both the Russian and EU markets; and

-- Economic growth, a stable currency, and a favorable business environment.

¶45. The U.S. is the sixth largest investor in Lithuania. American companies have invested USD 481 million, constituting 8.5% of total FDI, as of November 30, 2004. There are 584 companies with American capital registered in Lithuania. Total FDI was LTL 14.65 billion (USD 5.68 billion) on July 1, 2004. Per capita FDI is USD 1382. More than 60 percent of incoming FDI is from the EU-15 countries. FDI from the EU-15 increased by ten percent in 2003, reaching USD 3 billion. Lithuania's FDI stock constituted 26 percent of GDP on January 1, 2003. FDI flow, as a proportion of GDP, was 5.3 percent in 2002 and 3.8 percent in 2001. The most attractive sectors for foreign investment in 2003 were:

-- The processing sector, 31.1 percent of total FDI;

-- The trade sector, 17.9 percent;

-- Transportation and communications, 17.1 percent; and

-- Financial mediation, 15.7 percent.

¶46. Lithuania's top five foreign investment sites (2002 data) are:

-- Latvia, USD 19 million;

-- Estonia, USD 15 million;

-- Russia, USD 8.6 million;

-- Bosnia, USD 5.3 million; and

-- France, USD 3.6 million.

Total Lithuanian investment abroad amounts to USD 73 million.

¶47. The top ten foreign countries investing in Lithuania (2004 data) are:

-- Denmark (FDI: USD 827 million as of January 1, 2004; up

from USD 788 million as of January 1, 2003);

-- Sweden (FDI: USD 700 million as of January 1, 2004; down from USD 702 million as of January 1, 2003);

-- Germany (FDI: USD 465 million as of January 1, 2004; up from USD 440 million as of January 1, 2003);

-- United States (FDI: USD 405 million as of January 1, 2004; up from USD 398 million as of January 1, 2003);

-- Estonia (FDI: USD 401 million as of January 1, 2004; down from USD 539 million as of January 1, 2003);

-- Finland (FDI: USD 408 million as of January 1, 2004; up from USD 204 million as of January 1, 2003);

-- Russia (FDI: USD 277 million as of January 1, 2004; up from USD 239 million as of January 1, 2003);

-- U.K. (FDI: USD 236 million as of January 1, 2004; down from USD 237 million as of January 1, 2003);

-- Netherlands (FDI: USD 163 million as of January 1, 2004; up from USD 83 million as of January 1, 2003); and

-- Norway (FDI: USD 146 million as of January 1, 2004; up from USD 135 million as of January 1, 2003).

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